

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:NER:MAN:TL-N-7191-99  
PSchneiderman

date:

to: District Director, Manhattan District  
Quality Measurement Staff  
Attn: Gerald Feig, Restricted Interest Reviewer

from: District Counsel, New York CC:NER:MAN

subject:

December 31, [REDACTED] and December 31, [REDACTED]  
I.R.C. § 6402(b) Credit Elect Issue

U.I.L. Number: 6402.01-02

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We have been asked for assistance to determine the period during which interest accrues on a certain portion of the above-captioned taxpayer's income tax deficiencies for the taxable years ended December 31, [REDACTED] and December 31, [REDACTED]. The advice rendered in this memorandum is conditioned on the accuracy of the facts provided to us.

FACTS

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Application of Overpayment for [REDACTED]

[REDACTED] (the "taxpayer") timely filed its Federal income tax return, on extension, on or about [REDACTED]. The return, as filed, reported an overpayment of approximately \$[REDACTED]. The taxpayer elected to apply the entire overpayment to its [REDACTED] estimated tax.

Excluding the [REDACTED] overpayment, the taxpayer made estimated tax payments for [REDACTED] of approximately \$[REDACTED], \$[REDACTED], \$[REDACTED], and \$[REDACTED] for the first, second, third, and fourth quarters, respectively. The minimum payment due from the taxpayer for each quarter was approximately \$[REDACTED]. Each quarter was, therefore, overpaid, effectively precluding application of the \$[REDACTED] credit elect to any of the quarters.

On [REDACTED], the taxpayer was assessed a deficiency for the [REDACTED] year in the amount of approximately \$[REDACTED] and corresponding interest of approximately \$[REDACTED]. The Service began computing interest on \$[REDACTED] of the deficiency, equal to the credit elect, as of [REDACTED], the due date of the taxpayer's first estimated tax installment for [REDACTED]. The remainder of the interest on the deficiency was computed as of [REDACTED], the due date of the return. According to the taxpayer, the accrual of interest on \$[REDACTED] of the deficiency, equal to the credit elect, should not start until [REDACTED], the due date of the subsequent year's return. The taxpayer agrees with the Service's assessment of interest on the portion of the tax liability in excess of the credit elect.

#### Application of Overpayment for [REDACTED]

The taxpayer timely filed its [REDACTED] Federal income tax return, on extension, on or about [REDACTED]. The return, as filed, reported an overpayment of approximately \$[REDACTED]. Of this amount, approximately \$[REDACTED] was used to satisfy existing liabilities in other related tax modules. The taxpayer elected to apply the remaining amount of the overpayment, about \$[REDACTED], to its [REDACTED] estimated tax.

Excluding the [REDACTED] overpayment, the taxpayer made estimated tax payments for [REDACTED] of approximately \$[REDACTED], \$[REDACTED], and \$[REDACTED] for the first, second, and fourth quarters, respectively. The taxpayer made no estimated tax payment for the third quarter. The minimum payment due by the taxpayer for each quarter was approximately \$[REDACTED]. The excess amounts paid in the first and second quarters (\$[REDACTED] and \$[REDACTED] excess, respectively), however, more than satisfied the total estimated tax payments due for the third quarter and the made up for the shortfall in the forth quarter. In fact, the taxpayer overpaid its total estimated tax liability for [REDACTED], effectively precluding application of the \$[REDACTED] credit elect to any of the quarters.

On [REDACTED], the taxpayer was assessed a deficiency for the [REDACTED] year in the amount of approximately \$ [REDACTED] and corresponding interest of approximately \$ [REDACTED]. Additional deficiency interest of about \$ [REDACTED] was assessed on [REDACTED]. The Service began computing interest on \$ [REDACTED] of the deficiency, equal to the credit elect, as of [REDACTED], the due date of the taxpayer's first estimated tax installment for [REDACTED]. The remainder of the interest on the deficiency was computed as of [REDACTED], the due date of the return. According to the taxpayer, the accrual of interest on \$ [REDACTED] of the deficiency, equal to the credit elect, should not start until [REDACTED], the due date of the subsequent year's return. The taxpayer agrees with the Service's assessment of interest on the portion of the tax liability in excess of the credit elect.

#### ISSUE:

What is the correct starting date for accrual of interest on the portion of the tax deficiency assessed for the taxable years [REDACTED] and [REDACTED], equal to the amount of the credit elect made with respect to those years.

#### DISCUSSION:

In general, the Government is entitled to interest on a ~~deficiency in tax~~ for the period during which the tax was due and unpaid. I.R.C. § 6601(a); *Avon Products v. United States*, 588 F.2d 342 (2d Cir. 1978). If a deficiency in tax is determined after the taxpayer elected to credit a return overpayment against its estimated tax liability for the next succeeding year, interest will begin to accrue on the amount of the deficiency equal to the amount of the return overpayment as of the effective date of the credit elect. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also, Rev. Rul. 88-98, 1988-2 C.B. 356. Section 413 of the Tax Reform Act of 1984 provides that overpayments of tax will be credited against the estimated income tax for the next succeeding year with full regard to Revenue Ruling 77-475, 1977-2 C.B. 476.<sup>1</sup> Pub. L. No.

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<sup>1</sup> In 1983, the Service revoked Revenue Ruling 77-475. Rev. Rul. 83-111, 1983-2 C.B. 245. However, in response to public criticism and expected Congressional action, the Service promulgated Revenue Ruling 84-58, 1984-1 C.B. 254, which reinstated and modified Revenue Ruling 77-475 on March 30, 1984 by ruling that the Service should apply the overpayment to the first installment of estimated tax for the succeeding taxable

98-369, 98 Stat. 494. Revenue Ruling 77-475, in pertinent part, provides:

If an overpayment of income tax for a taxable year occurs on or before the due date of the first installment of estimated tax for the succeeding taxable year, the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election.

1977-2 C.B. at 476 (emphasis added). Accordingly, interest on the portion of the deficiency in the prior year equal to the credit elect begins to accrue on the due date of the installment of estimated tax for the succeeding taxable year against which the overpayment was credited in accordance with the taxpayer's designation. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also Rev. Rul. 88-98, 1988-2 C.B. 356. However, the deficiency becomes both due and unpaid, and thus triggers the running of interest on that deficiency, only when the overpayment balance, after the application to the succeeding tax year's estimated taxes, is less than the deficiency for the overpayment year.

Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, which modified Revenue Ruling 77-475, the Service will generally credit a reported overpayment of tax against the taxpayer's first installment of estimated income tax for the succeeding tax year unless the taxpayer attached a statement to its return that designated otherwise. However, in *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), the Court of Federal Claims concluded that the assumption behind the default rule in Revenue Ruling 84-58 was that the taxpayer had underpaid its first installment of estimated tax for the succeeding tax year. Thus, a return overpayment will not be credited for interest purposes to an installment of estimated tax due prior to the filing of the prior year's return if the taxpayer did not designate the particular installment of estimated tax against which to apply the return overpayment and if the installments of estimated tax due prior to the filing of the prior year's return were fully paid without the application of the return overpayment. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996). The Service has acquiesced in the *May Department Stores* decision. *May Department Stores Co. v. United States*, AOD

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year.

CC-1997-008 (Aug. 4, 1997).<sup>2</sup>

In light of the *May Department Stores* decision, the Service has reconsidered the manner in which interest on a subsequently determined deficiency is computed under I.R.C. § 6601(a) when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. AOD CC-1997-008 (Aug. 4, 1997); Also see Revenue Ruling 99-40, I.R.B. 1999-40, 441 (September 16, 1999). When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) on which the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated tax under I.R.C. § 6655 with respect to such year.

The date on which the overpayment becomes a payment on account of the succeeding year's estimated tax determines the date on which the prior year's tax became unpaid for purposes of I.R.C. § 6601(a). Prior to that date the Government has had the use of the funds with respect to the prior year's tax, and no interest is payable on the deficiency equal to the portion of the overpayment that is the subject of the taxpayer's election. See I.R.C. § 6402(b); Treasury Reg. § 301.6402-3(a)(5) and § 301.6611-1(h)(2)(vii). Interest should be charged from the point the prior year's tax is both due and unpaid. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997); *Avon Products, Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978); Rev. Rul. 88-98, 1988-2 C.B. 356.

In *Sequa Corporation v. United States*, 97-1 USTC ¶ 50,317 (S.D.N.Y. 1996), the taxpayer had elected to apply its 1990

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<sup>2</sup> The *May Department Stores* action on decision provides:

[F]or deficiency interest purposes, where a taxpayer does not initially designate a reported overpayment to satisfy a particular installment [of estimated tax] for the following year, and crediting of the return overpayment is not necessary to fully pay an installment of estimated tax due prior to the filing of the prior year's return, the reported overpayment will not be deemed to be credited to an installment of estimated tax due prior to the filing of the prior year's return.

*May Department Stores Co. v. United States*, AOD CC-1997-008 (Aug. 4, 1997).

overpayment to its 1991 estimated tax payments. Subsequently, the taxpayer filed its 1991 tax return showing that the taxpayer had made sufficient estimated tax payments (excluding the overpayment) to satisfy the subsequent year tax liability. Based on the facts before it, the Court opined that the interest on a subsequent tax assessment, up to the amount of the overpayment, begins to accrue on the due date of the subsequent year tax return. The Court reasoned that the overpayment was not "effective" as an estimated tax payment for the subsequent year and that the Service never lost the "use of the money."

The facts in instant case differ from the *May Department Stores* scenario, where estimated taxes for the succeeding tax year were not fully paid. But these facts bear a similarity to those in *Sequa*. Like the taxpayer in *Sequa*, the subject taxpayer overpaid its tax liabilities and elected to credit the overpayments to the succeeding years' estimated tax liabilities. More importantly, like the taxpayer in *Sequa*, the subject taxpayer made sufficient estimated tax payments, from sources other than the credit elect, to satisfy the succeeding years' estimated and actual tax liabilities. Under these circumstances, the overpayments made would not be considered effective as estimated tax payments for the subsequent years. *Sequa*, 97-1 USTC ¶ 50,317. Moreover, the Service is not seen as having lost the use of the overpayments during this time period. *Id.* Accordingly, interest on that portion of the deficiency assessed for the taxable years [REDACTED] and [REDACTED], equal to the amount of the credit elect made with respect to those years, would begin to accrue on the due date of the subsequent years tax return.

#### CONCLUSION

Based on the foregoing, we recommend that you allow the refund of interest requested by the taxpayer for each of the years. Interest on the [REDACTED] and [REDACTED] additional assessments, to the extent of the credit elect, will begin to accrue on [REDACTED] and [REDACTED], respectively.

If you have any questions regarding this matter, please contact Paul Schneiderman of our office at 264-1595, Ext. 290.

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